No. 87-835

Supreme Court, U.S.
FILED
DEC 31 1987
JOSEPH F. SPANIOL, JR.
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

ROBINSON HUMPHREY/AMERICAN EXPRESS, INC. and SHEARSON/AMERICAN EXPRESS INC.,

Petitioners,

v.

GLENN T. SANDERS and LESLIE D. SANDERS, on behalf of themselves and all others similarly situated,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

PETITIONERS' REPLY BRIEF IN SUPPORT OF THEIR PETITION FOR A WRIT OF CERTIORARI

HARVEY D. MYERSON
Counsel of Record
FINLEY, KUMBLE, WAGNER, HEINE, UNDERBERG, MANLEY, MYERSON & CASEY
425 Park Avenue
New York, New York 10022
(212) 371-5900

LLOYD S. CLAREMAN

MALCOLM D. YOUNG, JR.
PETER J. ANDERSON
PETERSON YOUNG SELF & ASSELIN

Attorneys for Petitioners

TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	iii
ARGUMENT	2
THE FRAUD-ON-THE-*UN*DEVELOPED-MARKET ISSUES RAISED IN THE PETITION WARRANT THIS COURT'S IMMEDIATE PLENARY REVIEW NOTWITHSTANDING THE INTERLOCUTORY POSTURE OF THIS CASE	2
A. *This Court Has Jurisdiction To Review Interlocutory, As Well As Final, Determinations*	3
B. *Substantially Identical Issues Are Currently Pending Before This Court In The* Basic Inc. *Action.*	4
C. *The Fraud-On-The-Undeveloped-Market Questions Raised By The Petition Are Clear-Cut Legal Issues Fundamental To The Further Conduct Of This Action*	5
D. *The Imperative National Importance Of The Fraud-On-The-Undeveloped-Market Questions Warrant Issuance Of A Writ Regardless Of The Interlocutory Status Of The Action*	7
E. *Denial Of The Petition Would Disserve Judicial Efficiency And Unnecessarily Avoid Resolution Of A Recurring Issue Which Evades Review*	9
CONCLUSION	10

TABLE OF AUTHORITIES

CASES	Page(s)
Arthur Young & Co. v. United States District Court, 549 F.2d 686, 695 (9th Cir.), *cert. denied*, 434 U.S. 829 (1977)	8
Basic Inc. v. Levinson, 107 S. Ct. 1284 (1987), *granting cert. to* 786 F.2d 741 (6th Cir. 1986)	*passim*
General Telephone Co. v. Falcon, 457 U.S. 147 (1982)	6
Gillespie v. United States Steel Corp., 379 U.S. 148 (1964)	3, 9
Nixon v. Fitzgerald, 457 U.S. 731 (1982)	3
Shearson/American Express, Inc. v. McMahon, 107 S. Ct. 2332 (1987)	6
Shores v. Sklar, 647 F.2d 462 (5th Cir. 1981) (*en banc*), *cert. denied*, 459 U.S. 1102 (1983)	5, 9
STATUTES, RULES AND REGULATIONS	
Federal Rules of Civil Procedure Rule 23	*passim*
Securities and Exchange Commission Regulations Rule 10b-5, 17 C.F.R. § 240.10b-5	*passim*
Securities Exchange Act of 1934 Section 10(b), 15 U.S.C. § 78j(b)	2
BOOKS AND PERIODICALS	
Note, *The Fraud On The Market Theory*, 95 Harv. L. Rev. 1143, 1157-58 n.56 (1982)	9
R. Stern, E. Gressman & S. Shapiro, *Supreme Court Practice* (6th ed. 1986)	3, 4

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Petitioners, The Robinson-Humphrey Company, Inc. and Shearson Lehman Brothers Inc., respectfully submit this reply brief to address the points raised by respondents in their brief in opposition to the petition.

Rather than addressing head-on the merits of the petition, which raises the issue of the validity of the fraud-on-the-*un*developed-market theory in class action cases brought pursuant to Section 10(b) of the Securities Exchange Act of 1934 – an issue of imperative national importance – respondents choose instead to attack the petition on the technical ground that the case is not "ripe" for this Court's review merely because the Eleventh Circuit "neither granted nor denied class certification" (Respondents' Brief at 12) and remanded the case back to the district court to make that determination.

In light of the overriding import of the substantive issue presented by the petition, respondents' "ripeness" argument must fail. The issue of the validity of the fraud-on-the-*un*developed-market theory presents a clear-cut legal question which is fundamental to the further conduct of this action as well as to a plethora of other securities cases brought on a nationwide scale. Thus, the issue merits Supreme Court review irrespective of the procedural posture of this case; otherwise, the issue would continue to evade review as it has done before.

With this Court's granting of certiorari in *Basic Inc. v. Levinson* to address the validity of the fraud-on-the-developed-market theory, it makes utmost sense for the Court to address the issue raised in the instant petition – the validity of that doctrine's application to *un*developed markets – at the same time. Petitioners respectfully submit that it would be inordinately inefficient and counter-productive to allow the points raised in this petition to remain unaddressed when all aspects of the fraud-on-the-market theory could be resolved with finality.

ARGUMENT

THE FRAUD-ON-THE-*UN*DEVELOPED-MARKET ISSUES RAISED IN THE PETITION WARRANT THIS COURT'S IMMEDIATE PLENARY REVIEW NOTWITHSTANDING THE INTERLOCUTORY POSTURE OF THIS CASE

The thrust of respondents' opposition brief is the argument that certiorari should be denied and review of the fraud-on-the-*un*developed-market issues should be "postponed" until a final

judgment has been entered in this case. In advancing this position, however, respondents bypass the fact that insisting on final judgment as a prerequisite to review will mean, in all likelihood, that these critical issues will not be reviewed for many years, if ever. Notably, even respondents do not contest the overriding national importance of the question of the fraud-on-the-*un*developed-market doctrine's validity, its pervasive application in major securities class actions, and the fact that most such cases never reach final judgment due to the *in terrorem* effect of their sheer size, which forces most cases presenting this issue to settle irrespective of their lack of substantive merit. These considerations warrant issuance of the writ notwithstanding the interlocutory posture of the case.

A. *This Court Has Jurisdiction To Review Interlocutory, As Well As Final, Determinations*

Respondents' brief asserts, in substance, that certiorari must be denied on the basis of the procedural posture of this case. To the contrary, however, this Court has the discretion to grant certiorari to review judgments of federal courts of appeals, irrespective of the procedural posture of the case below. Thus, where

> there is some important and clear-cut issue of law that is fundamental to the further conduct of the case and that would otherwise qualify as a basis for certiorari, the case may be reviewed despite its interlocutory status.

R. Stern, E. Gressman & S. Shapiro, *Supreme Court Practice* 225 (6th ed. 1986).

Indeed, this Court frequently has exercised its discretionary jurisdiction in such cases despite their nonfinal posture. *See, e.g., Nixon v. Fitzgerald*, 457 U.S. 731, 743 (1982) (petitioner raised " 'serious and unsettled' question"); *Gillespie v. United States Steel Corp.*, 379 U.S. 148, 153 (1964) (questions presented were " 'fundamental to the further conduct of the case' ").

In light of this authority, respondents' broad and hypothetical references to the alleged potential pitfalls of interlocutory review are inapposite. As demonstrated below, those illusory concerns are far outweighed by the numerous factors militating in favor of review on certiorari.

B. *Substantially Identical Issues Are Currently Pending Before This Court In The* Basic Inc. *Action*

Inexplicably, respondents ignore *Basic Inc. v. Levinson*, 107 S. Ct. 1284 (1987), *granting cert. to* 786 F.2d 741 (6th Cir. 1986).[1] Respondents say not a word about *Basic Inc.* despite the fact that Point I of the instant petition is devoted to that companion case, and despite the fact that this Court's grant of certiorari in *Basic Inc.* is itself sufficient to warrant certiorari here.

> Where the petition for certiorari presents a question that is identical with, or similar to, an issue already pending before the Supreme Court in another case in which certiorari had been granted, the issue is obviously important and the Court will either grant the petition and set the case for argument, or postpone consideration of the petition until the other case has been decided and then make summary disposition of the case in accordance with that decision.

R. Stern, E. Gressman & S. Shapiro, *Supreme Court Practice* 221 (6th ed. 1986). The interlocutory posture of this case does not render the fraud-on-the-market issues raised herein any less important or any less "certworthy" than those already identified as such in *Basic Inc.* Indeed, if the "traditional" fraud-on-the-market theory is sufficiently controversial to merit the granting of a writ of certiorari in *Basic Inc.*, then *a fortiori* the extension of that theory by the Eleventh Circuit in the instant case to *undeveloped* markets, despite the absense of any justification for

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[1] Respondents' sole reference to the *Basic Inc.* action is in a string citation of cases adopting the fraud-on-the-market theory in the open-market context. (*See* Respondents' Brief at 18 n.11.)

its application on economic or legal grounds, warrants the granting of the instant petition.

C. *The Fraud-On-The-Undeveloped-Market Questions Raised By The Petition Are Clear-Cut Legal Issues Fundamental To The Further Conduct Of This Action*

This petition is an exceptionally compelling vehicle for review of the fraud-on-the-*un*developed-market doctrine. In reversing the trial court's denial of class certification of respondents' Rule 10b-5(1) and (3) claims, the Eleventh Circuit embraced *Shores v. Sklar*, 647 F.2d 462 (5th Cir. 1981) (*en banc*), *cert. denied*, 459 U.S. 1102 (1983), and expressly overturned the lower court's "rejection of the fraud-on-the-market theory as a basis for class action treatment" of those claims. (*See* Appendix to Petition, filed Nov. 23, 1987, at A-6.) Indeed, the Eleventh Circuit's application of the *Shores* doctrine to those claims provided the dispositive ground for that court's reversal of the district court's holding.

Thus, contrary to respondents' characterization, an opinion rendered by this Court on certiorari in this action would be anything but "advisory." (Respondents' Brief at 12.) The questions raised by the fraud-on-the-*un*developed-market doctrine in the context of this case are neither abstract, hypothetical, nor contingent. The court below adopted the doctrine as the law of the Eleventh Circuit and the case, and in the absence of that holding the district court's denial of Rule 10b-5(1) and (3) certification surely would be reaffirmed on remand. Thus, if the class is to pursue those subsection (1) and (3) claims, it can do so only on a fraud-on-the-*un*developed-market theory.[3]

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[3] Respondents' argument that the petition should be denied on the ground that "the 'fraud on the market' theory is not implicated at all with respect to several of respondents' other claims" (Respondents' Brief at 15), is a *non sequitur*. Given the fact that the Eleventh Circuit grounded its Rule 10b-5(1) and (3) holding on the fraud-on-the-*un*developed-market doctrine, that doctrine will play a fundamental role in the trial-level proceedings unless the class chooses to abandon those claims. The existence of other counts in the complaint is wholly irrelevant.

Manifestly, the validity of the fraud-on-the-*un*developed-market doctrine is a question fundamental to the course and disposition of this action. Moreover, the Court can reach the issue without wading through a factual morass – indeed, without resolving a single disputed question of fact. The clarity of the issue will not be enhanced by further development of the record on remand.

Respondents' speculations of prospective mootness (*see* Respondents' Brief at 13-14) also do not diminish the propriety of plenary review at this time. One such scenario raised by respondents, an ultimate verdict for petitioners on the merits, is not only remote in time, but, if considered by this Court to be a serious obstacle to review on certiorari, would have precluded the Court from hearing the majority of the important interlocutory cases which it has in fact entertained in the past and would severely impede this Court's review of important issues.

Historically, the Court has not considered the potential for ultimate victory by the petitioner to be the obstacle to certiorari that respondents hold it out to be, certainly not where the legal issues raised in the petition are as important as they are here. For example, the fact that petitioners in *General Telephone Co. v. Falcon*, 457 U.S. 147, 155 (1982), might ultimately have been successful in defending that suit did not dissuade this Court from granting "certiorari to decide whether the class action was properly maintained" even while the merits of the respondents' claims "remain[ed] open for reconsideration in the District Court on remand . . . ." By way of further example, this Court recently reviewed on certiorari an interlocutory holding by the Second Circuit that arbitration agreements were unenforceable as to RICO and Rule 10b-5 claims. *Shearson/American Express, Inc. v. McMahon*, 107 S. Ct. 2332 (1987). The *McMahon* petitioners' writ was granted despite the possibility that, had the claims been tried to a jury, the arbitrability issue may have been mooted by a verdict for the petitioners.

Similarly unpersuasive is respondents' assertion (*see* Respondents' Brief at 13) that the fraud-on-the-*un*developed-market issue is not ripe for review because it could be rendered moot

by the character of any class ultimately certified or by subsequent district court modification of any such certification order. First, the composition or recomposition of any class will not moot the fraud-on-the-*un*developed-market issues as long as any claims based on that doctrine are allowed to proceed.[3]

Second, if respondents are suggesting that the trial court might ultimately bar class prosecution of respondents' fraud-on-the-*un*developed-market claims, that scenario would be substantially identical to that of a trial verdict for petitioners. Neither hypothetical scenario is relevant to the granting of the requested writ if, as is the case here, the issue of law presented is clear-cut, fundamental to the proceeding, and otherwise certworthy. *See supra* p. 3.

D. ***The Imperative National Importance Of The Fraud-On-The-Undeveloped-Market Questions Warrant Issuance Of A Writ Regardless Of The Interlocutory Status Of The Action***

The petition sets forth in detail why the fraud-on-the-*un*developed-market doctrine lacks a principled basis in law or economics, how the doctrine nevertheless effects an unreasonable abandonment of the Rule 10b-5 reliance requirement without providing an adequate replacement link in the chain of causation, and how the doctrine therefore has been justifiably questioned and criticized. The petition also shows how the application of the doctrine to undeveloped markets actually conflicts with the rationale underlying its developed-market counterpart as well as with the developed-market theory's provisions for the rebuttal of any presumed reliance based on that theory.

Respondents' brief ignores or glosses over these and the other points raised in the petition, but cannot obscure the national importance of the issues presented therein. This becomes obvious upon examination of the arguments that respondents attempt

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[3] Likewise, if petitioners were to challenge successfully the adequacy of respondents as class representatives, that event would not moot the fraud-on-the-*un*developed-market issues because respondents presumably would continue to pursue such claims in their individual capacities.

to raise with respect to those issues, and the points raised in the petition which they ignore.

First, respondents advance the same "unmarketability"/but-for causation analysis (*see, e.g.*, Respondents' Brief at 16-17) discredited in the petition (*see* Petition at 16-18). For example, in support of that analysis, respondents quote *Arthur Young & Co. v. United States District Court*, 549 F.2d 686, 695 (9th Cir.), *cert. denied*, 434 U.S. 829 (1977), for the proposition that

> the purchaser of an original issue security relies, at least indirectly, on the *integrity of the regulatory process* and the truth of any representations made to the appropriate agencies . . . at the time of the original issue.

(Respondents' Brief at 18 (emphasis added).)

Reliance on the regulatory process, however, is not an adequate replacement for actual reliance on misstatements, for reasons which respondents themselves provide: "the SEC does not guarantee or pass judgment upon the qualitative soundness of particular securities . . . ." (Respondents' Brief at 20.) It would be unsound policy to sanction, as a matter of law, an investor's claim that he relied on the regulators to perform tasks they in fact do not perform; such reliance, if real, would be unreasonable. Moreover, since the regulators do not evaluate the intrinsic soundness of a security, they simply cannot provide a causal link between an alleged fraud and an investor who was injured by purchasing a so-called "unmarketable" security.

Second, respondents fail to dispose of the conflict inherent in the application of the fraud-on-the-market theory to undeveloped markets: the efficient market hypothesis, which is the theoretical underpinning of the fraud-on-the-developed-market doctrine, is inoperative by definition in the context of undeveloped, inefficient markets.[4]

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[4] With regard to the conflict created by the Eleventh Circuit's rejection of the rebuttal options afforded defendants in developed-market contexts,
(footnote continued on next page)

In short, respondents' points in opposition fail to diminish the importance of the issues presented by the petition, an importance manifested by this Court's decision to hear substantially identical issues in the developed-market context of *Basic Inc.*

E. *Denial Of The Petition Would Disserve Judicial Efficiency And Unnecessarily Avoid Resolution Of A Recurring Issue Which Evades Review*

Respondents propose that petitioners' challenge to the fraud-on-the-*un*developed-market doctrine be made "as part of the normal appellate process after final judgment . . . ." (Respondents' Brief at 13.) There is irony in this stance given the fact that it was respondents who deviated from the "normal" appellate process by seeking and gaining interlocutory review in the first instance. But even placing that aside, their position is ill-considered, for the postponement they advocate would be highly inefficient and counter-productive to the further conduct of this and other Rule 10b-5 class action cases.

The eventual costs of this action "will certainly be less if [the Court] pass[es] on the questions presented here rather than send the case back with those issues undecided." *Gillespie v. United States Steel Corp.*, 379 U.S. 148, 153 (1964). More important, however, will be the savings in time and other resources throughout the judiciary nationwide. The fraud-on-the-market doctrine historically has evaded this Court's review despite its recurring presence in the courts below. This petition represents

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(footnote continued from previous page)

respondents simply ignore the conflict. They do state at one point that the Eleventh Circuit sanctioned a "rebuttable" presumption of reliance, but that is a misstatement. (*See* Petition at 14-16.) So, too, is respondents' assertion that "[e]ven the so-called 'critics' of the theory concede its applicability, as the Eleventh Circuit applied it here, to claims under subsections (1) and (3) of Rule 10b-5. *See* Note, *The Fraud On The Market Theory*, 95 Harv. L. Rev. 1143, 1157-58 n.56 (1982)." (Respondents' Brief at 19.) In this instance, respondents misrepresent the author's views. The footnote cited merely elaborates on an argument which the author identifies as one arguable "rationale" for the *Shores* decision, an argument he then expressly rejects as "not convincing." 95 Harv. L. Rev. at 1157-58.

the undeveloped-market complement to the *Basic Inc.* action, and thus affords the Court a timely opportunity to address the fraud-on-the-market doctrine in full. The judicial efficiencies which would attend such a determination merit the granting of the petition herein.

CONCLUSION

For all of the foregoing reasons, petitioners respectfully urge the Court to grant their petition.

Dated: New York, New York
December 31, 1987

HARVEY D. MYERSON
Counsel of Record
FINLEY, KUMBLE, WAGNER, HEINE,
UNDERBERG, MANLEY, MYERSON & CASEY
425 Park Avenue
New York, New York 10022
(212) 371-5900

LLOYD S. CLAREMAN

MALCOLM D. YOUNG, JR.
PETER J. ANDERSON
PETERSON YOUNG SELF & ASSELIN

Attorneys for Petitioners